CHAPTER III

Agenda for the Future

What is it that remains to be done now that the new monetary system, as the U.S. Treasury Secretary William Simon called it, has been ushered in?

The significance of the Jamaica decisions, it appears to us, lay less in that in a new and fundamentally different situation which had emerged with respect to exchange rates the Governments could at last agree to give every country the freedom to choose its own exchange arrangement. The significance of the Jamaica decisions lay really in that the Governments sought to sweep under the carpet the major questions relating to liquidity, including the apportionment of the gains of liquidity creating.

Creation of New Reserves

Whatever may be one's assessment of the liquidity needs of a monetary system based largely on floating exchange rates, as opposed to the liquidity needs of a par value system, the fact cannot be ignored that at the time of the Jamaica Agreement the ratio of total monetary reserves to aggregate imports, after revaluation of monetary gold, could not have been higher than 0.30. Compare this to the corresponding ration of 0.70 in the early 50s and 0.50 in the early 60s. Now, it is certainly possible that the reserve needs of the new monetary system will be lower not only because of the flexible exchange rates but also because of the far greater access, now than ever before, to international capital market for balance of payments financing. Let us accept that the reserve needs will be lower hereafter on both these counts. Let us also assume that the ratio of reserves to imports need be only around 0.25. If world trade expands hereafter at the rate of only 5 per cent in real terms - the lowest rate in any one year since 1970 - the ratio of 0.25 will have been reached in 1979. If we assume instead that the average rate of growth of world trade in real terms will be 8.5 per cent as in the 1960s, then the ratio of 0.25 will have been crossed in mid-1978.

In the above calculations, no allowance is made for the increase in price of either traded goods or gold. The gold price will have to keep rising at two and a half times the rate of increase in world trade, in terms of value, in order to keep the ratio of reserves to world trade constant. This, of course, assumes that gold revaluation alone carried the responsibility of augmenting the monetary reserves - an assumption which goes absolutely contrary to the proposed objective of reducing the monetary rate of gold. There is, at the same time, another aspect of a continuing gold revaluation which is that once the expectation of price rise is built in, it will immobilize the monetary gold stocks and therefore increase the need for non-gold reserves.

So the question of the non-gold component of monetary reserves will be important even under the new monetary system. This brings us to the SDRs. At Jamaica, the matter of expanding the SDRs was simply not mentioned. Right from the start of the discussions on SDRs in mid-60s, the ghost of inflation was always haunting the deliberations. The increasing needs for liquidity have come to be met in the process by either the deficits of the reserve centres or,

more recently, the creation of credit by the Euro-dollar market. Both of these sources of credit are subject however to virtually no international control and regulations. But the lesson has still not been drawn that the creation of credit under proper international auspices would be far more restrained and therefore much less inflationary as well as destabilising. The point remains that while everybody seemed to agree that the SDR should be made the principal reserve asset of the new monetary system, the one concrete step necessary to ensure this viz., the continuing expansion of SDRs, controlled but adequate, to meet the genuine non-inflationary needs of the world trade under the new monetary system, was completely omitted.

True that it was agreed in Jamaica to increase the quotas in the Fund by 32.5 per cent and that, as a consequence, increased Fund credit will be available to members. But let us not ignore the difference between Fund credit and other liquidity including SDRs, namely that the Fund credit, even in the first credit tranche, has a certain measure of conditionality attached to it.[23]

Now if monetary gold, in-spite of its immediate revaluation after the Jamaica Agreement, remains immobilised and since the SDRs have been assigned no role to meet the increase in the liquidity needs of the new monetary system, it follows that these needs will have to be met entirely out of the creation of what the Fund has now chosen to call freely usable currencies but which are really the same as reserve currencies at the old system. True, all the members agreed at Jamaica that the Fund should try to make use of as large a number of currencies in its operations and transactions in the future as possible; it is most unlikely however that more than a few currencies will actually be so used by the Fund.[24] What is no less important is that even between the few freely usable currencies, there is nothing in the new system to prevent the emergence once again of one dominant currency. In fact, under the new system where there is no obligation to convert one's currency holding abroad into gold, the reserve currency country need not be unduly perturbed at expansion of its currency liabilities abroad. Of course, this lack of concern might not ultimately be shared by the creditor countries which are accumulating reserves in the form of liabilities of one country, however economically strong and powerful the latter might be and however voluntary those accumulations may have been to start with. Even if these creditor countries do not have the choice then of converting their reserve currency holdings into gold the problem of impaired confidence in the accumulations of the reserve currency could still emerge. That indeed is probably going to be the soft part of the new system's underbelly.[25] But that precisely is the sort of situation which might well lead to a clamour for the return to gold as the principal reserve asset and to the virtual repetition of the scenario that evolved during the period, 1945 to 1969.

Regulation of Euro-dollar Market

To the extent that, on the one hand, balance of payments finance is provided by the Euro-dollar market and, on the other hand, monetary authorities keep their surplus reserves in that very market, it will be extremely important for the smooth functioning of the international monetary system that the Euro-dollar market works on an even keel. Its destabilizing impact could otherwise be large indeed. The question of international control over this market is therefore something that cannot be avoided for long.

Equitable Distribution of Gains

As for the transfer of real resources involved in the creation of reserves, its regressive impact is bound to become more serious than in the past. The more the international monetary system relies on the creation of liquidity by a few countries, which are also usually the strongest and the richest, the more regressive is the resultant real resource transfer. As for the revaluation of gold, its regressiveness in the context of the present distribution of monetary gold is too obvious to stress.

There is however only one possibility, somewhat remote though, of some alleviation and that can eventuate if the oil exporting countries choose to deploy their reserve holdings differently than in recent past. The international monetary system, knew as much as the old one, gives these countries with surplus very little choice with respect to the placement of their reserves. Today, they face a monopsonistic credit market where few borrowers - with one very strong borrower in the lead though - can virtually dictate their terms to the lenders. But it is not difficult to devise a system, at the all-world level or at the group level, which would give these countries the opportunity to diversify their reserve placements. In the process, the inequalities as well the inefficiency of the real resource transfer involved in reserve creation to-day can also be reduced.[26] However, as things stand today, whatever transfer of real resources is involved in the creation of additional international liquidity will be very regressive under the new system.

It should be added also that the creation of international credit in the form of SDRs which are allocated in accordance with the present quotas in the Fund could, by no standard, be considered progressive with respect to real resource transfer. Still this method of creating additional liquidity whereby about one-quarter is allocated to the developing countries is less regressive than when the entire liquidity is created, directly or indirectly, on the basis of the deficit of one or two rich reserve centres. There can be no question therefore about where the interests of the developing countries would lie between SDR-based liquidity allocated on the basis of the quotas in the Fund and the liquidity created by the reserve centres or the non-resident branches of their commercial banks.

The Jamaica Agreement spoke about making SDRs the principal reserve asset, but not the only reserve asset, of the new monetary system. Therefore, even if it were possible to agree, in the near future, on an active role for SDRs in providing additional liquidity, it is unlikely that the SDRs newly created will meet more than a fraction of the additional liquidity needs of the system. So the problem of regressive resource transfer will still remain with us, and in quite a big way. Therefore, the problem of devising a more equitable as well as more efficient system of reserve creation will have to stay on the agenda for world monetary reform.

Conclusion

To sum up, Jamaica can at best be regarded as the beginning of reform. It must be followed up by decisions on gold, SDRs, reserve currency creation and the control of Euro-dollar market. Reform efforts over the coming months, and possibly years, must concentrate on these major issues and not get bogged down with less important issues. The major issues identified in this paper are also, we believe, the issues that should be of concern to the developing countries.

If demonetisation of gold can be accelerated, it should brighten the prospects of SDR creation and the more the liquidity needs of the new World monetary system are met through the creation of SDRs, rather than reserve currency creation the less regressive will the real resource transfer be. The international regulation of reserve currency creation, whether by monetary authorities or in the Euro-dollar market, should also serve the same purpose. One must add, however, that this order of priority will only ensure the minimum for the developing world. The developed world could do a lot more for its developing counterpart within the framework of the new monetary system if they were more generously disposed than to-day when even the minimum appears to elude.